SECTOR UPDATE

Banking – Malaysia

Chugging Along

The sector delivered 1Q24 earnings growth of 7% which was broadly in line with expectations. As the sector is trading at its historical mean valuation and is anticipated to lag the FBMKLCI's earnings growth, we perceive the current risk-to-reward ratio as being well balanced. In the absence of meaningful earnings catalysts, we maintain MARKET WEIGHT on the sector. CIMB remains our top pick.

WHAT'S NEW

- **1Q24 sector earnings broadly in line.** Malaysian banks reported results that were broadly in line, with six out of the nine banks we cover reporting earnings that were in line. Two were above (HLBank and Alliance Bank on lower-than-expected credit cost due to write-backs) and one below (Affin was impacted by lower-than-expected NIM). 1Q24 sector earnings grew 7% yoy, supported by strong non-interest income growth of 28%. However higher provisions (+35% yoy) and 5bp yoy slippage in NIM capped the overall earnings growth upside.
- **Sector has underperformed FBMKLCI marginally.** The KL Finance index has slightly underperformed the FBMKLCI by 0.3% ytd, rising 9.1% compared to the FBMKLCI's 9.3% increase. Lacking strong fundamental catalysts, sentiment among banks has been mixed. Only four banks, CIMB, Alliance, BIMB and Affin, outperformed the sector. CIMB, BIMB and Alliance benefited from strong earnings growth and attractive valuations, while Affin's outperformance was driven by the entry of the Sarawak government's investment arm as a strategic shareholder. However, Affin's recent earnings delivery was disappointing.
- **Tactical positioning ahead of potential risk-on mode in 2H24.** In light of the peakish interest rate cycle and moderating inflationary outlook in the US, interest in emerging markets including Malaysia is likely to gain momentum. In this respect, we opine that CIMB will continue to be a key beneficiary of this theme which has played out well ytd.
- **2024 earnings growth outlook to lag KLCI at only 7%.** In 2024, sector earnings growth is anticipated to decrease to 7%, down from 15% in 2023, primarily due to the absence of the prosperity tax and a slower expansion in non-interest income. However, a more stable NIM outlook and a rebound in loan growth, projected at 5.5-6.0% (compared with 5.3% in 2023), are expected to support overall growth. Overall banking sector earnings growth of 7% is unexciting, lagging our KLCI earnings growth projection of 13%.

ACTION

- **Maintain MARKET WEIGHT.** The sector is trading at its historical mean P/B of 1.10x which we deem to be fair, considering the absence of strong catalysts. Sector earnings growth of 7% is expected to lag the broader market's projected 11% rise in 2024 earnings. This is primarily due to factors such as: a) flattish NIM with slight downside risk, b) anticipated slowdown in non-interest income growth, and c) absence of material credit cost tailwinds. Overall, sector dividend yields are attractive, surpassing 5% with stable asset quality.

MARKET WEIGHT

(Maintained)

SECTOR PICKS

Company	Rec	Share Price (lcy)	Target Price (lcy)
CIMB	BUY	6.68	7.60
Public	BUY	4.03	5.10

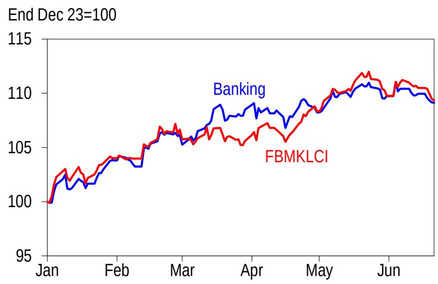
Source: UOB Kay Hian

BANKS' SHARE PRICE PERFORMANCE

Company	Price (RM)	yoy % chg	ytd % chg
Affin Bank	2.49	33.9	19.7
CIMB Group	6.68	29.6	14.3
Bank Islam	2.49	29.0	12.1
Alliance Bank	3.75	11.6	11.2
Maybank	9.88	13.0	9.6
AMMB	4.25	17.4	5.4
HLFG	17.06	(2.2)	3.8
HL Bank	19.16	1.9	2.6
RHB Bank	5.52	2.2	1.3
Public Bank	4.03	3.9	(5.8)

Source: Bloomberg

BANKING INDEX UNDERPERFORMED THE FBMKLCI



Source: Bloomberg

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PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US$m)	PE 2023 (x)	PE 2024F (x)	PE 2025F (x)	ROE 2024F (%)	P/B 2024F (x)	Div 2024F (sen)	Div Yield (%)
Public Bank	PBK MK	BUY	4.03	5.10	16,598	11.0	11.2	10.5	12.5	1.4	18.1	4.5
CIMB Group	CIMB MK	BUY	6.68	7.60	15,157	10.2	8.9	8.5	11.4	1.0	41.2	6.2
Maybank	MAY MK	HOLD	9.88	9.55	25,296	11.9	11.4	10.9	10.1	1.1	64.8	6.6
HL Bank	HLBK MK	HOLD	19.16	22.18	8,813	10.9	9.6	9.2	11.7	1.1	69.7	3.6
RHB Bank	RHBBANK MK	HOLD	5.52	5.88	5,106	7.9	8.1	7.3	8.7	0.7	37.3	6.8
HLFG	HLFG MK	HOLD	17.06	19.86	4,146	7.6	7.0	6.6	10.1	0.7	41.9	2.5
AMMB	AMM MK	HOLD	4.25	4.28	2,981	8.7	8.1	7.7	8.7	0.7	23.0	5.4
Alliance Bank	ABMB MK	HOLD	3.75	4.10	1,232	8.5	7.9	7.6	10.0	0.8	23.7	6.3
Bank Islam	BIMB MK	HOLD	2.49	2.29	1,197	9.3	9.0	8.7	7.6	0.7	13.8	5.5
Affin Bank	ABANK MK	SELL	2.49	2.05	1,268	12.0	10.0	9.1	4.3	0.4	11.2	4.5

Source: Bloomberg, UOB Kay Hian

- **Our top sector pick is CIMB Group.** Our preference for CIMB Group as the top pick is based on: a) its high beta, b) having the highest foreign shareholding among the banks, and c) strong ROE trajectory. These factors position the stock favourably to capitalise on a growing risk-on investment environment premised on an eventual Federal Reserve interest rate pivot.

ESSENTIALS

- **More muted non-interest income growth in 2024.** We anticipate a moderation in non-interest income growth to 6% in 2024 (compared with +25% in 2023), primarily due to a more subdued performance in treasury-related income. The 10-year Malaysian Government Securities (MGS) yield has stabilised at the pre-pandemic level of 3.90%, with expectations of BNM maintaining the OPR at the current level of 3.00%, akin to pre-pandemic levels, thus we foresee limited opportunities for banks to further benefit from a decline in MGS yields.

- **GIL ratio remains stable.** The banking sector has maintained a relatively stable GIL ratio of 1.62% vs the pre-COVID-19 average of 1.55%, largely achieved through more aggressive bad debt write-offs and recovery measures.

- **Minimal write-backs factored in as banks may take a wait-and-see approach on potential impact of targeted subsidies and higher consumption tax.** Our 2024 sector net credit cost assumption of 22bp is only marginally below the pre-COVID-19 average of 25bp like 2023's 23bp. This suggests that we have not accounted for a significant reversal in excess provisions even through 2024, because we prefer a cautious approach as the rollout of various targeted subsidies and consumption tax could impact asset quality in 2024 and even 1H25. If any reversals occur, we believe Public Bank has the most potential for write-backs given its robust loans loss coverage (LLC).

- **Adequate provision buffers.** Overall net credit cost is expected to remain below the pre-pandemic level and be relatively stable vs 2023 levels. This expectation is based on the fact that banks have already allocated sufficient pre-emptive provisions. For instance, the aggregate LLC ratio, for banks under our coverage, stood at 113% as of 1Q24, surpassing pre-pandemic average levels of 92%. Public Bank leads with the highest ratio at 169%.

- **Flattish to slight compression in 2024 NIM.** Given the near-term deposit competition from digital banks, coupled with competition among conventional banks in certain lending segments such as mortgages, we expect 2024 sector NIM to remain slightly challenging with a potential downside risk to our current flattish outlook. Overall, we project the sector's NIM at 2.05% in 2024 (2023: 2.05%), compared with pre-pandemic levels of about 2.10%, even as the OPR has normalised to its pre-pandemic levels.

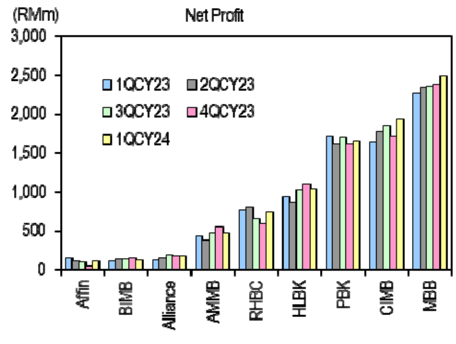
- **Stability should still prevail.** That said, a more disciplined pricing strategy for loans yields and, to a certain extent, deposits should help keep overall NIM stable in 2024 vs 2023 as compared with the 25bp compression witnessed in 2023 vs 2022 due to intense deposit competition.

- **Stronger loans growth in 2024 - uptick in business loans…** Anticipating a modest recovery, we expect system loans growth to fall within the range of 5.5-6.0% (2023: 5.3%). This upturn is driven by a stronger business loans growth projection of 5.5-6.0%, compared with the current growth rate of 4.6% in 2023. Factors supporting this expectation include: a) multiplier effect from stronger FDI, b) higher development expenditure, and c) the ongoing recovery of the tourism sector.

- **…partially offset by slight moderation in household loans.** Partially offsetting the uptick in business loans growth is a slight moderation expected in household loans growth to 5.5%, down from 2023's 5.8%. Specifically, auto loans growth is projected to decrease on the 2023 high-base effect, transitioning from 9.8% in 2023 to 8.0%. Conversely, mortgage loans growth is anticipated to remain relatively stable at 7%, supported by the progressive drawdown of a robust pipeline of existing mortgage stocks.

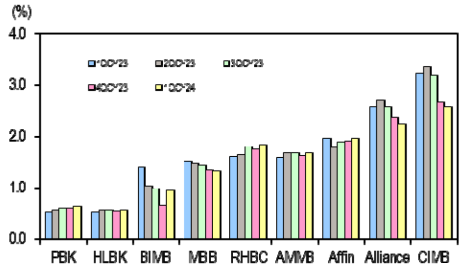
- **Key events to look out for and take note of in 2H24** include: a) Monetary Policy Committee (MPC) meeting in July, September and November, where our economics team expects Bank Negara (BNM) to retain the overnight policy rate (OPR) at 3.00%; b) a slight uptick in loans growth to 5.5-6.0% vs 2023's estimated 5.3% on stronger business loans growth of 3.0-3.5%, up from the prevailing growth of 2.5%; c) a slight easing in deposit competition in tandem with peakish interest rate cycle; and d) banking sector's gross impaired loan (GIL) ratio potentially peaking.

BANKS NET PROFIT TREND



Source: UOB Kay Hian, Banks

BANKS GIL TREND



Source: UOB Kay Hian, Banks

BANKS LLC COMPARISON

	1Q24 (%)	Pre-Covid period (%)
Affin	100	42
Alliance	97	80
AMMB	91	64
BIMB	123	174
CIMB	101	70
HLBank	154	107
Maybank	121	72
Pbank	169	125
RHB	70	93
Average	113	92

Source: UOB Kay Hian, Banks

SECTOR PB

Source: UOB Kay Hian

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